

Accounting for Corporations

Chapter 13

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Fundamental Accounting Principles

25th Edition

Chapter 13 Learning Objectives

CONCEPTUAL

C1 Identify characteristics of corporations and their organization.

C2 Explain characteristics of, and distribute dividends between, common and preferred stock.

C3 Explain the items reported in retained earnings.

ANALYTICAL

A1 Analyze earnings per share, price-earnings ratio, and dividend yield.

PROCEDURAL

P1 Record the issuance of corporate stock.

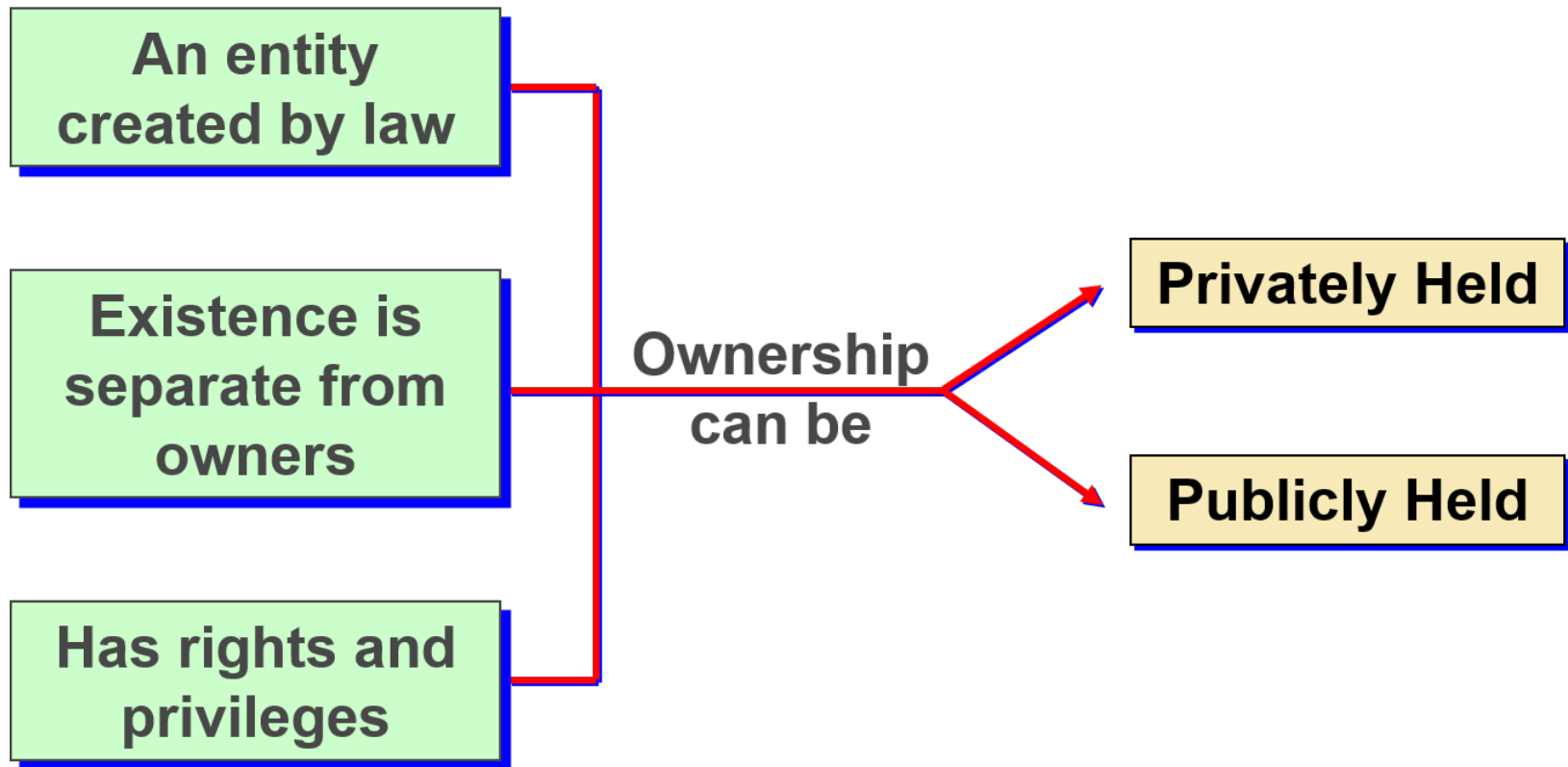
P2 Record transactions involving cash dividends, stock dividends, and stock splits.

P3 Record purchases and sales of treasury stock.

Learning Objective C1

Identify characteristics of corporations and their organization.

Corporate Form of Organization



Learning Objective C1: Identify characteristics of corporations and their organization.

Characteristics of Corporations

Advantages

- **Separate legal entity**
- **Limited liability**
- **Transferable ownership rights**
- **Continuous life**
- **No mutual agency for stockholders**
- **Easier capital accumulation**

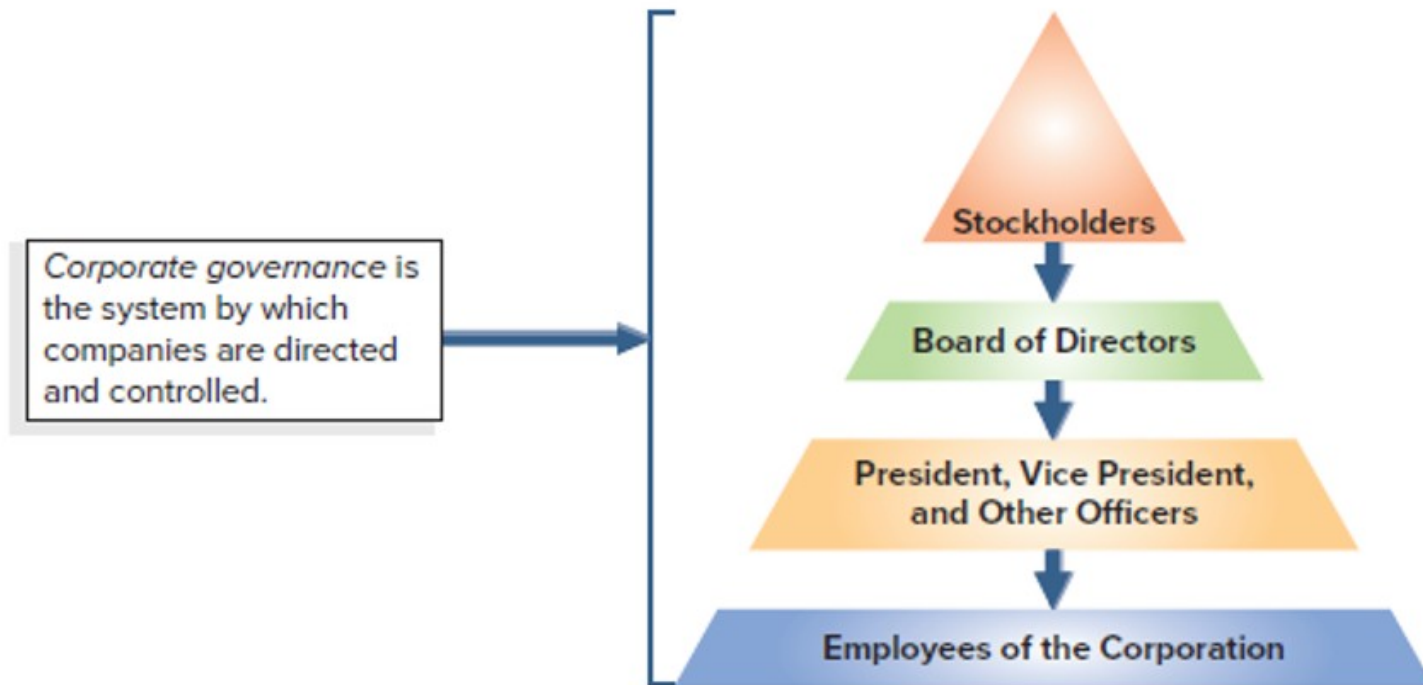
Disadvantages

- **Governmental regulation**
- **Corporate taxation**

Learning Objective C1: Identify characteristics of corporations and their organization.

Corporate Organization and Management

Exhibit
13.1



Learning Objective C1: Identify characteristics of corporations and their organization.

Rights of Stockholders

1. Vote at stockholders' meetings (or register proxy votes)
2. Sell or dispose stock
3. Purchase proportional additional shares of stock
4. Receive dividends, if any
5. Share in any assets remaining after creditors and preferred stockholders are paid in a liquidation

Stock Certificates and Transfer

Exhibit
13.2

Each unit of ownership is called a **share of stock**.

A stock certificate serves as proof that a stockholder has purchased shares.

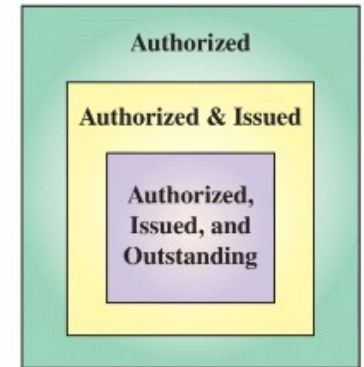


Learning Objective C1: Identify characteristics of corporations and their organization.

Basics of Capital Stock

- Authorized stock: number of shares that a corporation's charter allows it to sell.
- Par Value stock: amount assigned per share.
- No-Par Value stock: not assigned an amount per share.
- Stated Value stock: no-par stock that has an assigned "stated" value per share.
- Stockholders' equity consists of:
 1. Paid-in (contributed) capital: total amount of cash and other assets corporation receives from its stockholders in exchange for its stock.
 2. Retained earnings: cumulative net income (and loss) not distributed as dividends to its stockholders.

Subcategories of Authorized Stock

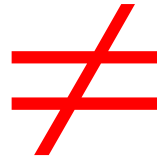


Innermost box would show a decline in shares issued if a company buys back its issued stock.

Learning Objective 1 Identify the characteristics of corporations and their organization.

Basics of Capital Stock: Par Value vs. Market Price

Par value is an arbitrary amount assigned to each share of stock when it is



Market price is the amount that each share of stock will sell for in the market.

Classes of Stock

- **Par Value**
- **No-Par Value**
- **Stated Value**

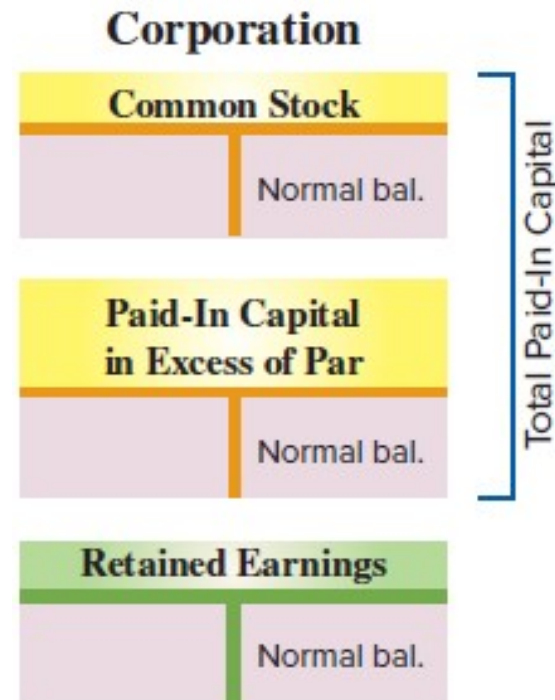
Stockholders' Equity

Exhibit
13.3

Stockholders' equity (or shareholders' equity or corporate equity) consists of:

- **Paid-in (contributed) capital - cash and other assets received in exchange for stock**
- **Retained earnings - cumulative net income**

(loss) not distributed as dividends.



Learning Objective C1: Identify characteristics of corporations and their organization.

Learning Objective P1

Record the issuance of
corporate stock.

Issuing Par Value Stock at Par

Par Value Stock

On June 5, Dillon Snowboards, Inc. issued 30,000 shares of \$10 par value stock for \$300,000.

Let's record this transaction.

June 5	Cash	300,000	
	Common Stock, \$10 Par Value*		300,000
	<i>Issued 30,000 shares of \$10 par value stock at par.</i>		
	*\$10 par value × 30,000 shares		

Issuing Par Value Stock at a Premium

Par Value Stock

On June 5, Dillon, Inc. issued 30,000 shares of \$10 par value stock for \$12 per share. Let's record this transaction.

June 5	Cash	360,000	
	Common Stock, \$10 Par Value*		300,000
	Paid-In Capital in Excess of Par Value, Common Stock†		60,000
	<i>Sold and issued 30,000 shares of \$10 par value common stock at \$12 per share.</i>		
*\$10 par value × 30,000 shares		†[\$12 issue price – \$10 par value] × 30,000 shares	

Learning Objective P1: Record the issuance of corporate stock.

Issuing Par Value Stock

Exhibit
13.4

Common stock—\$10 par value; 50,000 shares authorized; 30,000 shares issued and outstanding	\$300,000
Paid-in capital in excess of par value, common stock	60,000
Retained earnings*	<u>65,000</u>
Total stockholders' equity	<u><u>\$425,000</u></u>

*This is the company's first year of operations, with income of \$65,000 and no dividends.

Issuing No-Par Value Stock

No-Par Value Stock

On October 20, Dillon issued 1,000 shares of no-par value stock for \$40 per share. Let's record this transaction.

Oct. 20	Cash	40,000	
	Common Stock, No-Par Value*		40,000
	<i>Issued 1,000 shares of no-par stock at \$40 per share.</i>		

*\$40 issue price × 1,000 no-par shares

Issuing Stated Value Stock

Stated Value Stock

On October 20, Dillon issued 1,000 shares of \$40 stated value stock for \$50 per share.

Let's record this transaction.

Oct. 20	Cash	50,000	
	Common Stock, \$40 stated value*		40,000
	Paid-In Capital in Excess of stated value, Common Stock†		10,000
	<i>Issued 1,000 shares of \$40 per share stated value stock at \$50 per share.</i>		
*\$40 stated value × 1,000 shares	†[\$50 issue price – \$40 stated value] × 1,000 shares		

Learning Objective P1: Record the issuance of corporate stock.

Issuing Stock for Noncash Assets₁

Par Value Stock

On June 10, 4,000 shares of \$20 par value stock is given for land valued at \$105,000.

Let's record this transaction.

June 10	Land	105,000	
	Common Stock, \$20 Par value*		80,000
	Paid-In Capital in Excess of Par value, Common Stock†		25,000
	<i>Exchanged 4,000 shares of \$20 par value stock for land</i>		

*\$20 Par value × 4,000 shares

†\$105,000 asset value – \$80,000 par value

Learning Objective P1: Record the issuance of corporate stock.

Issuing Stock for Noncash Assets₂

Par Value Stock

On June 5, 600 shares of \$15 par value stock is issued for \$12,000 of organizing work.

June 5	Organization Expenses	12,000	
	Common Stock, \$15 Par value*		9,000
	Paid-In Capital in Excess of Par value, Common Stock†		3,000
	<i>Gave promoters 600 shares of \$15 par value common stock in exchange for their services.</i>		
*\$15 Par value × 600 shares		†\$12,000 services value – \$9,000 par value	

Learning Objective P1: Record the issuance of corporate stock.

Learning Objective P2

Record transactions involving cash dividends, stock dividends, and stock splits.

Cash Dividends

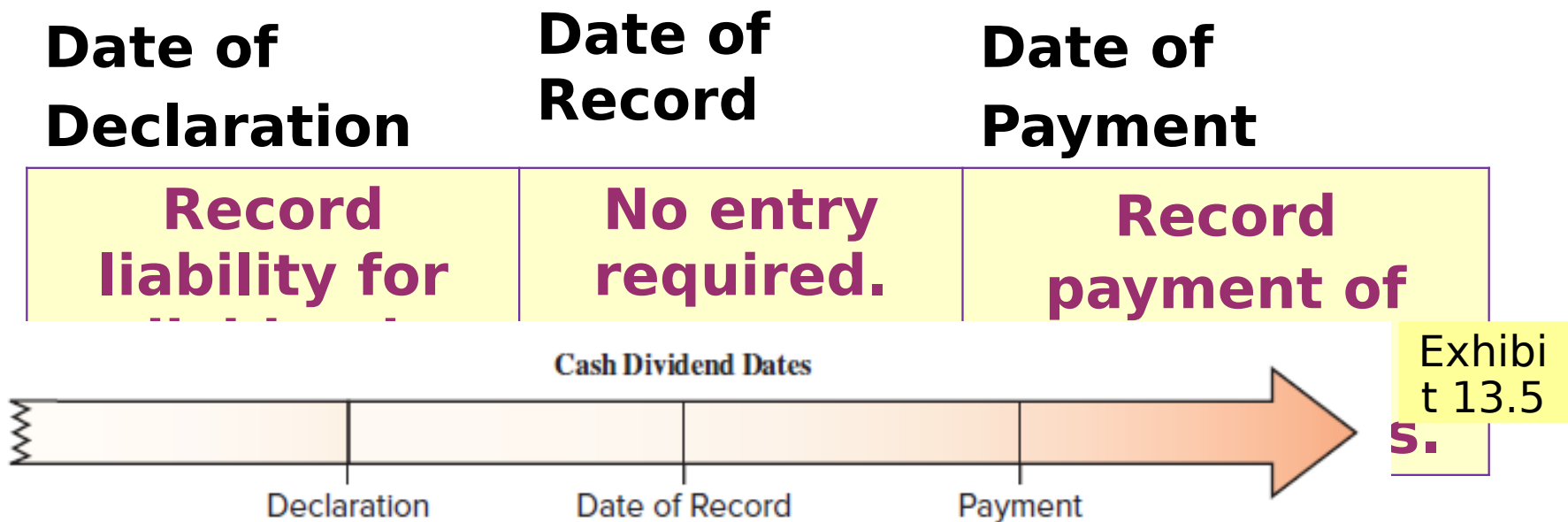
Cash dividends provide a return to investors and almost always affect the stock's market value.

To pay a cash dividend, the corporation must have:

1. A sufficient balance in retained earnings;
and
2. The cash necessary to pay the dividend.

Cash Dividend Dates

Three Important Dates



Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Accounting for Cash Dividends: Date of Declaration

On January 9, a \$1 per share cash dividend is declared on Z-Tech, Inc.'s 5,000 common shares outstanding. The dividend will be paid on February 1 to stockholders of record on January 22.

Record liability for dividend.

Date of Declaration—Cash Dividend

Jan. 9	Retained Earnings	5,000	
	Common Dividend Payable*		5,000
	<i>Declared \$1 per common share cash dividend[†]</i>		
	<i>*\$1 per share declared dividend × 5,000 outstanding shares</i>		

[†]To aid learning and show how dividends impact retained earnings, we **debit** (reduce) **Retained Earnings** on the date of declaration in this chapter and all assignments. We normally debit Dividends; then, at period-end, Dividends is closed to Retained Earnings. The effect is the same: Retained earnings is decreased from dividends.

Learning Objective P1: Prepare adjusting entries for deferral of expenses.

Accounting for Cash Dividends: Date of Payment

On January 9, a \$1 per share cash dividend is declared on Z-Tech, Inc.'s 5,000 common shares outstanding. The

dividend will be paid on February 1 to

No entry required on January 22, the date of record on January 22.

Feb. 1	Common Dividend Payable	5,000	
	Cash		5,000
	<i>Paid \$1 per common share cash dividend.</i>		

Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Stock Dividends

A distribution of a corporation's own shares to its stockholders without receiving any payment in return.

Why a stock dividend?

- **Used to keep the market price on the stock affordable.**
- **Show management's confidence that company is doing well.**

Small Stock Dividend

Distribution is $\leq 25\%$ of the previously outstanding shares.

Large Stock Dividend

Distribution is $> 25\%$ of the previously outstanding shares.

Recording a Small Stock Dividend

Quest has 10,000 shares of \$10 par value stock outstanding. On December 31, Quest declared a 10% stock dividend, when the stock was selling for \$15 per share. The stock will be distributed to stockholders on January 20. Let's prepare the December 31 entry.

Capitalize retained earnings for the market value of the shares to be distributed. ($10,000 \times 10\% = 1,000 \times \$15 = \$15,000$)

**$1,000 \times \$10$
par**

Dec. 31	Retained Earnings	15,000	
	Common Dividend Distributable*		10,000
	Paid-In Capital in Excess of Par Value, Common Stock†		5,000
*10% dividend $\times$ 10,000 outstanding shares $\times$ \$10 par value Declared a 10% stock dividend of 1,000 shares			
†10% dividend $\times$ 10,000 outstanding shares $\times$ [\$15 market price – \$10 par value]			

Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Recording a Small Stock Dividend: Stockholders' Equity

Dec. 31	Retained Earnings	15,000	
	Common Dividend Distributable*		10,000
	Paid-In Capital in Excess of Par Value, Common Stock†		5,000
*10% dividend declared × 10,000 outstanding shares × \$10 par value †10% dividend × 10,000 outstanding shares × [\$15 market price – \$10 par value]			

Exhibit
13.6

Stockholders' Equity	Before Divide nd	Date of Declarati on	Date of Paymen t	After Dividen d
Common stock—\$10 par value, 15,000 shares authorized, 10,000 shares issued and outstanding	\$100,000	\$	\$ +10,000	\$110,000
Common stock dividend distributable—1,000 shares	0	+10,000	–10,000	0
Paid-in capital in excess of par value, common stock	8,000	+ 5,000		13,000
Retained earnings	35,000	–15,000		20,000
Total stockholders' equity	<u>\$143,000</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$143,000</u>

Recording a Small Stock Dividend: Date of Payment

Quest has 10,000 shares of \$10 par value stock outstanding. On December 31, Quest declared a 10% stock dividend, when the stock was selling for \$15 per share. The stock will be distributed to stockholders on January 20. Let's prepare the January 20 entry.

June 20	Common Stock Dividend Distributable	10,000	
	Common Stock, \$10 Par Value		10,000
	<i>Record issuance of common stock dividend.</i>		

Recording a Large Stock Dividend

Quest, Inc. has 10,000 shares of \$1 par value stock outstanding. On December 31, Quest declared a 30% stock dividend. The stock will be distributed to stockholders on January 20, 2021. Let's prepare the December 31 entry.

Capitalize retained earnings for the minimum amount required by state law, usually par or stated value of the shares.

$$(10,000 \times 30\% = 3,000 \text{ shares} \times \$10 \text{ par value} = \$30,000)$$

Dec. 31	Retained Earnings	30,000	
	Common Stock Dividend Distributable*		30,000
	*30% dividend x 10,000 outstanding shares x \$10 par value <i>Declared a 30% stock dividend of 3,000 shares.</i>		

Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Stock Splits

A distribution of additional shares of stock to stockholders according to their percent ownership.

\$20 par value

Common Stock

100,000 shares

← Old
Share
S

→ New
Shares

\$10 par value

Common Stock

200,000 shares

Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Financial Statement Effects of Dividends and Splits

	Cash Dividend	Small Stock Dividend	Large Stock Dividend	Stock Split
Total assets	Decrease	No change	No change	No change
Total liabilities	No change	No change	No change	No change
Total equity	Decrease	No change	No change	No change
Common stock	No change	Increase	Increase	No change
Paid-in capital in excess of par	No change	Increase	No change	No change
Retained earnings	Decrease	Decrease	Decrease	No change

Learning Objective P2: Record transactions involving cash dividends, stock dividends, and stock splits.

Learning Objective C2

Explain characteristics of, and distribute dividends between, common and preferred stock.

Issuance of Preferred Stock

If Dillon issues 50 shares of \$100 par value preferred stock for \$6,000 cash, the entry is:

July 1	Cash	6,000	
	Preferred Stock, \$100 Par Value*		5,000
	Paid-In Capital in Excess of Par Value, Preferred Stock†		1,000
	<i>Issued preferred stock for cash.</i>		

*\$100 par value × 50 shares

†\$6,000 cash – [\$100 par value × 50 shares]

Exhibit 13.7

Equity section of year-end balance sheet for Dillon is:

Stockholders' Equity

Preferred stock—\$100 par value; 1,000 shares authorized; 50 shares issued and outstanding	\$ 5,000
Paid-in capital in excess of par value, preferred stock	1,000
Common stock—\$10 par value; 50,000 shares authorized; 30,000 shares issued and outstanding	300,000
Retained earnings	<u>65,000</u>
Total stockholders' equity	<u>\$371,000</u>

Reasons for Issuing Preferred Stock

Reasons for Issuing Preferred Stock

- To raise money without sacrificing control
- To boost the return earned by common stockholders through **financial leverage**
- To appeal to investors who may believe the common stock is too risky or that the expected return on common stock is too low

Learning Objective C2: Explain characteristics of, and distribute dividends between, common and preferred stock

Dividend Preference of Preferred Stock

Cumulative

vs.

Noncumulative

Dividends in arrears
must be paid before
dividends may be paid
on common stock.
(Normal case).

Undeclared dividends
from current and prior
years do not have to
be paid in future
years.

Learning Objective C2: Explain characteristics of, and distribute dividends between, common and preferred stock.

Dividend Preference of Preferred Stock: Illustration

Exhibit 13.8

Consider the following Stockholders' Equity section of the Balance Sheet. The Board of Directors declares \$5,000 of dividends in Year 1. In Year 2, the Board declared and paid cash dividends of \$42,000.

Preferred Stock Is Cumulative	Preferred	Common	Preferred Stock Is NonCumulative	Preferred	Common
Year 1	<u>\$ 5,000</u>	<u>\$ 0</u>	Year 1	<u>\$ 5,000</u>	<u>\$ 0</u>
Year 2			Year 2		
Step 1: Dividend in arrears	\$ 4,000		Step 1: Current year's preferred dividend	\$ 9,000	
Step 2: Current year's preferred dividend	9,000		Step 2: Remainder to common		\$33,000
Step 3: Remainder to common		\$29,000	Totals for Year 1 & Year 2	<u>\$14,000</u>	<u>\$33,000</u>
Totals for Year 2	<u>\$13,000</u>	<u>\$29,000</u>	Year 2 Cumulative Preferred: \$13,000. Common: \$29,000. Total: \$42,000		
Totals for Year 1 & Year 2	<u>\$18,000</u>	<u>\$29,000</u>			

Year 2 Noncumulative Preferred: \$9,000. Common: \$33,000. Total: \$42,000

Learning Objective C2: Explain characteristics of, and distribute dividends between, common and preferred stock.

Learning Objective P3

Record purchases and sales of treasury stock.

Treasury Stock

Treasury stock represents shares of a company's own stock that has been acquired. A corporation might acquire its own stock to:

1. Use its shares to buy other companies.
2. Avoid a takeover of the company.
3. Reissue to employees as compensation.
4. Maintain a strong market.



Learning Objective P3: Record purchases and sales of treasury stock.

Purchasing Treasury Stock

On May 1, Cyber, Inc. purchased 1,000 of its own shares of stock in the open market for \$11.50

May 1	Treasury Stock, Common	11,500	
	Cash		11,500
	<i>Purchased 1,000 treasury shares at \$11.50 per share</i>		
	*\$11.50 cost per share × 1,000 shares		

Treasury stock is shown as a reduction in total stockholders' equity on the balance sheet.

Selling Treasury Stock at Cost

On May 21, Cyber sold 100 shares of its treasury stock for \$11.50 per share.

May 21	Cash	1,150	
	Treasury Stock, Common*		1,150
	<i>Received \$11.50 per share for 100 treasury shares costing \$11.50 per share.</i>		
	<i>*\$11.50 cost per share × 100 shares</i>		

Learning Objective P3: Record purchases and sales of treasury stock.

Selling Treasury Stock above Cost

On June 3, Cyber, Inc. sold an additional 400 shares of its treasury stock for \$12 per share.

June 3	Cash	4,800	
	Treasury Stock, Common*		4,600
	Paid-In Capital, Treasury Stock†		200
	<i>Received \$12 per share for 400 treasury shares costing \$11.50 per share.</i>		

*\$11.50 cost per share × 400 shares

†[\$12 issue price – \$11.50 cost per share]
× 400 shares

	Shares Per Share		Total
Sale	400	\$12.00	\$ 4,800
Cost	400	11.50	<u>4,600</u>
	Paid-In Capital		<u>\$ 200</u>

Learning Objective P3: Record purchases and sales of treasury stock.

Selling Treasury Stock below Cost

On July 10, Cyber sold an additional 500 shares of its treasury stock for \$11.20 per share.

June 10	Cash	5,600	
	Paid-In Capital, Treasury Stock*	150	
	Treasury Stock, Common [†]		5,750
	<i>Received \$11.20 per share for 500 treasury shares costing \$11.50 per share.</i>		
	* $\$11.20 \text{ issue price} - \$11.50 \text{ cost per share} = \$11.50 \text{ cost per share} \times 500 \text{ shares}$		

	Shares	Per Share	Total
Cost	500	\$11.50	\$ 5,750
Sale	500	11.20	<u>5,600</u>
Difference			<u>\$ 150</u>

Learning Objective P3: Record purchases and sales of treasury stock.

Learning Objective C3

Explain the items
reported in retained
earnings.

Statement of Retained Earnings

Retained earnings is the total cumulative amount of reported net income less any net losses and dividends declared.

Restricted Retained Earnings

Legal Restriction

Most states restrict the amount of treasury stock purchases to the

amount of retained earnings

Contractual Restriction

Loan agreements can include restrictions on paying dividends below a certain amount of retained earnings

Learning Objective C3: Explain the items reported in retained earnings.

Prior Period Adjustments

Prior period adjustments are corrections of material errors in past years' financial statements that result in a change in the beginning balance of retained earnings.

Exhibit
13.9

Statement of Retained Earnings

Retained earnings, Dec. 31, 2020, as previously reported	\$4,700
Prior period adjustment	
Cost of land incorrectly expensed (net of \$60 of income tax benefit)	<u>200</u>
Retained earnings, Dec. 31, 2020, as adjusted	4,900
Plus net income	800
Less cash dividends declared	<u>(300)</u>
Retained earnings, Dec. 31, 2021	<u><u>\$5,400</u></u>

Learnin
earnings

Statement of Stockholders' Equity

This is a more inclusive statement than the statement of retained earnings.

Exhibit
13.10

MAC INC. Statement of Stockholders' Equity For Year Ended December 31

	Common Stock	Paid-In Capital in Excess of Par	Retain ed Earnin gs	Treasury Stock	Total Equity
Beginning balance	\$ 2,000	\$ 20,000	\$ 50,000		\$ 72,000
Net income			30,000		30,000
Issuance of common stock	1,000	10,000			11,000
Purchase of treasury stock				\$ (15,000)	(15,000)
Cash dividends			(8,000)		(8,000)
Ending balance	\$3,000	\$30,000	\$72,000	\$(15,000)	\$90,000

Learning Objective A1

Analyze earnings per share, price-earnings ratio, and dividend yield.

Earnings Per Share

Earnings per share is one of the most widely cited accounting statistics.

Exhibit
13.11

Learning Objective A1: Analyze earnings per share, price-earnings ratio, and dividend yield.

Price-Earnings Ratio

This ratio reveals information about the stock market's expectations for a company's future growth in earnings, dividends, and opportunities.

Exhibit
13.12

Learning Objective A1: Analyze earnings per share, price-earnings ratio, and dividend yield.

Dividend Yield

Tells us the annual amount of cash dividends distributed to common stockholders relative to the stock's market price.

Exhibit
13.12

Learning Objective A1: Analyze earnings per share, price-earnings ratio, and dividend yield.

End of Chapter 13